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No. _____

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

RUSSELL STOVER CANDIES, INC.
a Missouri corporation,
Appellant,

— v —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Appellee.

On Appeal from the Supreme Court of Montana

JURISDICTIONAL STATEMENT

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QUESTIONS PRESENTED

1. Whether a State, without violation of the Due Process Clause of the Fourteenth Amendment to the Constitution, may apply a unitary business formula to a corporation and thereafter tax, as the corporation's income from its business activities conducted within the taxing State, income derived from other operations of the corporation where:

(a) The business activities of the corporation outside the taxing State are involved in the maufacture, sale and distribution of paper boxes and related products, none of which occur in the taxing State, and the business activities of the corporation in the taxing State are limited to the operation of two cattle ranches which do not functionally contribute to or functionally assist the other activities of the corporation; and

(b) The sole connection between the business activities of the corporation in and out of the taxing State consist of the provision of some central management services to the cattle ranches by the home office of the corporation, located outside the taxing State, and the transfer of funds between the operations of the corporation in the taxing State and the general account of the corporation; and

2. Whether a State, without violation of the Due Process Clause of the Fourteenth Amendment to the constitution, may apply a unitary business formula to a corporation conducting business both within and outside the taxing State, where use of the formula results in the apportionment to the taxing State of 19% to 30% of the corporation's total net income, when

(a) The business operations of the corporation within the taxing State sustained losses in all the years involved; and

(b) The percentage of net income apportioned to the taxing State is four to five times the percentage of gross sales derived from the corporation's operations within the taxing State.[1]

[1] The Appellant has no parent companies, subsidiaries or affiliates. The taxpayer in the state courts was Ward Paper Box Company which has been merged into Russell Stover Candies, Inc. Ward Paper Box Company was not a subsidiary of Russell Stover Candies, Inc. during the tax years in question.

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On Appeal from the Supreme Court of Montana

JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Supreme Court of the State of Montana, following remand of this matter to it from this Court, is reported in 665 P.2d 198 (Mont. 1983). The earlier opinion of the Supreme Court of Montana is reported as *Ward Paper Box Company v. Department of Revenue of the State of Montana*, 638 P.2d 1053 (Mont. 1981). Included in the Appendix to the Jurisdictional Statement are copies of the Opinion of the Montana Supreme Court following remand (App. A, pp. 1-10); the Order of this Court vacating the judgment and remanding this matter to the Supreme Court of the State of Montana for reconsideration (App. A, p. 11); the initial Opinion of the Supreme Court of the State of Montana (App. A,

pp. 12-20); the unreported Opinion and Order of the District Court of the First Judicial District of the State of Montana, in and for the County of Lewis and Clark (the "District Court") (App. A, pp. 23-30); the unreported Findings of Fact, Conclusions of Law and Order of the State Tax Appeal Board of the State of Montana (App. A, pp. 31-41); and the unreported decision of the Hearing Officer of the Department of Revenue of the State of Montana (App. A, pp. 42-49).

JURISDICTION

This proceeding involves the application of Montana's corporate license tax statutes. For the purpose of computing the income tax due the State of Montana, the Montana Department of Revenue applied a "unitary business formula" to the operations of Ward Paper Box Company located within and outside the State of Montana. Appellant challenged this action on both statutory and constitutional grounds.

Appellant's arguments were rejected by the State Tax Appeal Board of the State of Montana and Appellant filed a Petition for Judicial Review with the District Court. Appellant's statutory arguments were upheld by the District Court. In its December 1981 decision, the Montana Supreme Court reversed and held that the unitary formula was properly applied to the operation of Appellant for the taxable years 1971 through 1975. As a result, income from operations occurring completely outside of Montana was included within the net income of the corporation for the purposes of computing the corporate license tax imposed upon Ward Paper Box Company for those tax years.

The Montana Supreme Court rendered its initial decision on December 21, 1981. The Appellant filed Notices of Appeal with the Montana Supreme Court and the District Court. Thereafter, the Appellant filed its Jurisdictional

Statement with this Court. The Department of Revenue filed a Motion to Dismiss Appeal, and the Appellant responded with a Brief in Opposition to the Motion to Dismiss Appeal. Thereafter, the Department of Revenue filed a Supplemental Brief. By Order of this Court dated October 4, 1982, reported at 74 L. Ed. 2d 41, this matter was remanded to the Supreme Court of the State of Montana for reconsideration in light of *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. ____, 102 S. Ct. ____, 73 L. Ed. 2d 787 (1982) and *F.W. Woolworth Co. v. Taxation and Revenue Department of the State of New Mexico*, 458 U.S. ____, 102 S. Ct. ____, 73 L. Ed. 2d 819 (1982).

Upon receipt of this Court's order, the Montana Supreme Court established a briefing schedule. The parties submitted briefs to the Court and oral argument was held on March 9, 1983. The Supreme Court of Montana rendered its decision following remand on May 19, 1983. The Appellant filed a petition for rehearing which was denied by the Montana Supreme Court by Order dated July 7, 1983. The Appellant filed Notices of Appeal with the Montana Supreme Court and the District Court on August 19, 1983.

This appeal is taken pursuant to the provisions of 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the Due Process Clause of the Fourteenth Amendment to the Constitution:

> No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty or property without due process of law. . . .

Section 15-31-301, Montana Code Annotated (MCA), states:

Corporations subject to allocation and apportionment. (1) Any corporation having income from business activity which is taxable both within and without this state shall allocate and apportion its net income as provided in this part.

(2) A corporation engaged in a unitary business within and without Montana must apportion its business income as provided for under 15-31-305. A business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of the business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as independent businesses.

(3) A corporation not engaged in a unitary business must allocate its business income by means of separate accounting methods, provided its books and records are so kept that the income and expenses attributable to business operations within the state can be properly segregated from total income and expense. If the corporation's books and records do not permit such proper segregation, its business income must be apportioned according to the provisions of 15-31-305.

STATEMENT OF THE CASE

Appellant, Russell Stover Candies, Inc., is the successor to all interests of Ward Paper Box Company, the taxpayer in the proceedings below. Ward Paper Box Company, a Missouri corporation, was merged into Russell Stover Candies, Inc., a Missouri corporation, which is the surviving corporation, by documents filed December 21, 1981. By order of the District Court dated March 19, 1982, Russell Stover Candies, Inc. was substituted for Ward Paper Box Company in this action. (App. D, pp. 60-61.)

Ward Paper Box Company was, in tax years 1971 through 1975, engaged in the business of manufacturing,

distributing and selling paper boxes and related products. It was a Missouri corporation qualified to do business in Montana. It maintained its principal place of business in Kansas City, Missouri. All of its common stock was owned by Mr. Louis Ward. (App. A, pp. 3, 13, 24.)

During the years in question, the activities of Ward Paper Box Company consisted of seven divisions. The divisions located outside of Montana were involved in the manufacture, sale and distribution of paper boxes and paper box products in the states of Kansas, Missouri, Colorado, South Carolina and Virginia. The Montana divisions consisted of two cattle ranch divisions; one in Meagher County and one in Powell County, Montana. (App. A, p. 31.) The paper box divisions did not manufacture, distribute or sell paper boxes or paper box products in Montana. These divisions did not engage in agricultural or livestock activities in Montana. The ranch divisions operated solely in Montana, producing livestock, hay, forage and other crops. (App. A, pp. 3, 13, 32.) The Montana State Tax Appeal Board recognized that the corporation was engaged in two business activities. (App. A., p. 38.)

At the Montana ranch divisions, the resident ranch manager made day-to-day managerial decisions. However, major decisions concerning the ranch divisions such as purchase of equipment and the purchase and sale of cattle required the approval of Mr. Louis Ward or the President of the Company. In addition, the Kansas City home office of the corporation prepared all federal and state reports, hired accountants to prepare tax returns, kept all books, prepared financial statements and balanced all checkbooks. Each ranching division was charged $60.00 per month for all home office services. On the other hand, there were no joint advertising programs, no common salesmen or common guarantees among the

divisions. Personnel of the box divisions did not transfer to the ranch divisions. The divisions did not exchange equipment and did not purchase products jointly.

Each division, including the Montana divisions, had an expense bank account maintained in Kansas City. Any monies generated by the division were deposited in the division's expense account. If the division did not immediately need the funds, those funds would be transferred from the separate division expense account to a general account of Ward Paper Box Company. Such funds would thereafter be utilzied when needed in any of the separate division operations. The President of Ward Paper Box Company would make the decision as to such transfers. When either of the Montana ranch divisions did not generate enough income to meet expenses, additional funds would be transferred from the general account to the ranch divisions' expense accounts.

Each ranch division maintained a payroll account in a Montana bank. Checks on those accounts could be written by the ranch manager. However, records were maintained in the Company's home office which also balanced the books and made deposits to the payroll account. (App. A, pp. 3-5, 13-15, 25.)

For the years 1971 through 1975, Ward Paper Box prepared and filed its Montana tax returns using a separate accounting method for the Montana ranch divisions. In each year, it paid the minimum corporation license tax of $50.00. During those years, the operating costs and depreciation expenses of the Montana divisions exceeded the income generated by those divisions. During the same time period, Ward Paper Box filed tax returns under the unitary apportionment method in the other states in which it operated. The Montana ranch divisions

were included as a part of its total unitary business in those returns. (App. A, pp. 3, 13-14.)

Appellee, Department of Revenue, determined that the Montana activities of Ward Paper Box Company were part of a unitary business. Thereafter the Department applied a unitary business formula in which the total income of the corporation, including the income generated by other divisions, was apportioned to Montana by use of a three-factor formula. The formula contrasted the property, payroll and sales of the Montana operations to the total property, payroll and sales of the corporation. The result was divided by three and yielded a percentage. This figure was applied to the total net income of the corporation to determine the income apportioned to the State of Montana.

The following table shows the computation made by the Appellee for the tax years involved:

	1975	1974	1973	1972	1971
SALES FACTOR					
From Sch 8 & 9					
Montana	$ 667,267	$ 673,011	$ 547,902	$ 110,732	$ 356,581
Total	9,045,536	10,055,532	8,408,684	9,753,830	7,222,509
Percent	7.3768%	6.6929%	6.5159%	1.1353%	4.9371%
PAYROLL FACTOR					
From Sch 6 & 7					
Montana	$ 295,737	$ 252,170	$ 229,777	$ 108,446	$ 62,843
Total	1,899,768	2,143,877	2,015,888	1,821,589	1,920,762
Percent	15.5670%	11.7623%	11.3983%	5.0534%	3.2718%
PROPERTY FACTOR					
From Sch 3-5					
Montana	$11,874,356	$11,189,290	$10,565,751	$ 7,214,205	$3,874,730
Total	17,417,592	16,615,058	14,970,861	11,190,376	7,649,961
Percent	68.1745%	67.3443%	70.5754%	64.4680%	50.6503%
Total Factors	91.1183%	85.7995%	88.4896%	71.5567%	58.8592%

(Div. 3) Aver.	30.3728%	28.5998%	29.4965%	23.8522%	19.6197%
Total Net Income	2,186,167	1,843,150	1,567,917	1,847,209	1,970,447
Income Allocated to Montana	664,000	527,137	426,481	440,600	386,596
Tax (6.75%)	44,770	35,582	31,217	29,740	26,095

Ward Paper Box challenged the application of the unitary business formula on both statutory and constitutional grounds. The State Tax Appeal Board of the State of Montana rejected both these challenges (App. A, pp. 31-40). As indicated above, the District Court upheld Appellant's statutory argument (App. A, pp. 23-30) and the Montana Supreme Court reversed, rejecting Appellant's statutory and constitutional arguments (App. A, pp. 1-10, 12-20).

The questions sought to be reviewed were raised in the District Court in Appellant's Petition for Judicial Review of the decision of the State Tax Appeal Board, filed on October 29, 1979. The questions were extensively briefed by the parties in the District Court. The District Court held that the activities of Ward Paper Box Company within the State of Montana were not part of a unitary business.

The questions presented here were raised in the initial appeal to the Supreme Court of Montana in the brief of the Taxpayer and extensively briefed by the parties. They were raised again in the Taxpayer's Petition for Rehearing. The Montana Supreme Court, in reversing the District Court, held that the Montana divisions of Ward Paper Box Company were a part of a unitary business and rejected both constitutional arguments raised by Appellant here.

Both questions raised here were raised and briefed by the Appellant in its Jurisdictional Statement and subse-

quent documents filed in its first appeal to this Court. Following remand to the Montana Supreme Court, both questions were again raised. The Montana court again held that the Montana divisions of the Ward Paper Box Company were part of a unitary business and rejected the constitutional arguments of the Appellant.

REASONS FOR NOTING JURISDICTION

This case raises two significant federal questions. The first is whether a State may constitutionally apply a unitary formula to a corporation whose operations within the taxing State form a distinct business enterprise which is functionally separate from the operations of the corporation outside the taxing State. Here, the sole connections between the corporation's Montana-based operations and its other operations are unity of ownership, the provision of some management and administrative services, and the transfer of funds. The decisions of the Montana Supreme Court, given the facts of this case, represent an extension of unitary business principle never before sanctioned by this Court. This initial question presents the Court with an opportunity to delimit the application of the unitary business principle.

The second question is whether a State may constitutionally apply a unitary business formula which apportions to the taxing State and subjects to taxation 19% to 30% of the net income of the corporation, derived from all of its operations, when the business operations within the taxing state sustained losses in all the years involved and produced no net income, when the business operations of the corporation within the taxing State produced only 1% to 7% of the Company's gross sales for the tax years in question, and when the percentage of net income apportioned to the taxing State is four to five times the percentage of sales derived from the corporation's operations

in the taxing State. The decisions of the Supreme Court of Montana eliminate the requirement of a rational relationship between the income attributed to the taxing state and the intrastate value of the enterprise.

A. *Constitutionality of the application of the unitary business principle to a corporation whose operations within the taxing State are a discrete business enterprise functionally separate from the corporation's out-of-state operations.*

Contrary to the Due Process Clause, Montana has applied the unitary business principle to the Appellant's business operations located within and outside of the State of Montana. In so doing it has taxed the extraterritorial net income of the Appellant. Application of the unitary business principle to the Appellant's business operations is constitutionally impermissible. The Appellant's business activities within Montana are functionally distinct and separate from its business operations outside the state and constitute distinct business enterprises.

The decisions of this Court require that the Appellant demonstrate, in order to establish that its income from operations outside the State of Montana is not subject to an apportioned tax in Montana, that the income was earned in the course of activities unrelated to its activities in Montana. *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980). As stated more recently, in order to permit application of the principle, the out-of-state activities of the purported unitary business must be related in some concrete way to the in-state activities. *Container Corporation v. Franchise Tax Board*, 51 U.S.L.W. 4987, 4989 (1983).

Here the Appellant has shown that its business of manufacturing, distributing and selling paper boxes and related products outside the State of Montana is distinct, in any business or economic sense, from its ranching activ-

ities in Montana. The Montana ranching operations are a distinct business enterprise which have no concrete relation to the Appellant's out-of-state operations.

This Court has sanctioned the use of the unitary business principle for vertically integrated companies with various components operating in several states. *Underwood Typewriter Company v. Chamberlain*, 245 U.S. 113 (1920). The principle has also been applied to vertically integrated companies operating in several countries. *Bass, Ratcliff, & Gretton v. State Tax Commission*, 226 U.S. 271 (1924). Application of the principle has been permitted in cases involving similar enterprises operating separately in several jurisdictions and having common managerial and operational resources. *Butler Brothers v. McColgan*, 315 U.S. 501 (1942). This principle has never been sanctioned for companies engaging in two distinct business operations, functionally separate, connected only by common ownership, minimal administrative ties, and flow of funds.

The Appellant's operations are not vertically integrated. Its operations do not begin with manufacture in Montana and sale in other states. Rather, its ranching activities are conducted solely within the state of Montana and its paper box manufacturing, distribution and sales activities are conducted in five other states with no relation at all to the state of Montana. Further, the in-state and out-of-state operations are totally dissimilar. There are no economies of scale such as central purchasing or advertising divisions serving both the ranching and paper box divisions. There is no exchange of equipment or transfer of personnel between the ranching and box divisions.

Early decisions of this Court established the rationale for application of the unitary business principle. Where a business earns profit through a series of transactions be-

ginning with manufacture in one state and ending with sales in another, the Legislature, in attempting to determine a fair tax burden for such a business, is faced with the impossibility of allocating specifically the profits earned by processes conducted within its borders. *Underwood Typewriter Company v. Chamberlain*, 254 U.S. at 120-121. Further, the accounting system used by a taxpayer operating in several jurisdictions may not reveal facts necessary to determine a fair tax burden. *Butler Brothers v. McColgan*, 315 U.S. at 507-508.

That rationale does not apply here. The facts of the operations conducted by the Appellant are evident. There is a distinct paper box manufacturing, distribution and sales operation and a separate ranching operation. Those operations share the minimum contacts which arise from unity of ownership. Further, there is no impossibility of allocating specifically the profits earned by processes conducted within Montana. No accounting system or corporate legal organization obscures the facts relating to the operation of the Appellant's distinct businesses.

As this Court has stated, "one must look principally to the underlying activity . . . to determine the propriety of apportionability." *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. at 440. The Appellant's Montana operations are completely distinct and discrete business activities having no functional relation to the Appellant's out-of-state enterprises. The decisions of the Montana Supreme Court, in determining that the Appellant's Montana operations can be deemed part of a unitary business, look past *underlying business activities* to factors unrelated to operational functions.

In claiming the ability to apply the unitary business principle to the Taxpayer, the Appellee relied upon the following factors:

1. The corporation's home office approved major management decisions for the Montana ranching operations;

2. The corporation's home office provided some administrative services to the Montana operations; and

3. The corporation's home office and the Montana ranch operations transferred funds.

The Montana Supreme Court adopted the Appellee's reasoning in determining that the Appellant's Montana operations were part of a unitary business.

The factors relied upon by the Appellee and the Montana court have no relation to the underlying business activities of the Montana operation and are insufficient to constitute a unitary business. Indeed, these elements have been found insufficient by this Court to evidence a unitary business.

1. *Management Decisions.*

The Appellee maintains that the management decisions for all divisions were made at the corporation's home office. Both the Montana State Tax Appeal Board and the State District Court found that the ranch manager made the day-to-day management decisions for the ranch divisions. Major management or financial decisions, such as those involving purchase of equipment or the buying or selling of cattle, required the approval of the chairman or president of the corporation. (App. A, pp. 25, 34).

In *Woolworth* this Court dealt with the question of whether the dividends received by a domestic corporation, from subsidiaries operating in foreign countries, could be apportioned to New Mexico. Unlike the present case, the parent and subsidiaries were involved in the same type of business activity. Major financial decisions of the subsidi-

aries, such as the amount of dividends to be paid and the creation of substantial debt, had to be approved by the parent corporation. Nonetheless, this Court concluded that the subsidiaries were not part of a unitary business. The Court found little integration of business activities and no centralization of the management of the parent and subsidiaries. It viewed as occasional oversight the parent's control of major financial decisions. *F.W. Woolworth Co. v. Taxation and Revenue Department*, 73 L. Ed. 2d at 831.

Similarly, in *ASARCO*, the Court noted with approval the decision of the Idaho Supreme Court, that a wholly-owned subsidiary engaged in an activity unrelated to the parent's business operations, was not part of a unitary business. There, the parent provided important management services to the subsidiary and the parent's direction and approval of the subsidiary's major policy decisions was required. *ASARCO, Inc. v. Idaho State Tax Commission*, 73 L. Ed. 2d at 801, n. 22.

Finally, it should be noted that the Appellant's involvement in management was not grounded on its own operational expertise or its overall operating strategy. The Appellant has no technical expertise in operating cattle ranches and left decisions relating to ranch operations to its resident manager. In this regard, the home office's involvement in management clearly differentiates this case from *Container*, where the parent's management involvement with its subsidiaries, operating in the same line of business, was grounded on its own expertise and operational strategy. *Container Corporation v. Franchise Tax Board*, 51 U.S.L.W. at 4993, n. 20.

When asked about the management responsibilities of the resident ranch managers, Mr. Louis L. Ward, the Chairman of the Board, responded that he did not "know

cattle well enough to buy them". Mr. Ward felt that he had not acquired enough knowledge of cattle operations and needed "a general manager to exercise the authority and make the decisions". In making livestock purchases the ranch manager would inform the home office that he was going to do so, and the home office would ask for an idea of how many cattle were being purchased and their approximate cost so the home office would be "sure to have the money after you have bought them to pay for them." Deposition of Louis L. Ward, p. 24.

It is particularly noteworthy that the major management decisions relied upon by Appellee were made during the time the ranches were first acquired. The Meagher County ranch was acquired in December, 1969, and the Powell County ranch in December, 1972. Neither ranch was purchased with livestock, which had to be acquired separately at later dates. The only evidence of home office involvement in cattle acquisition relates to the period of time when the ranches were being initially stocked for operation.

2. *Provision of Centralized Sevices.*

In a footnote in *Woolworth*, this Court addressed the provision of centralized services by a parent corporation to subsidiaries. There, the parent's published financial statements were prepared on a consolidated basis which included some of its subsidiaries. In finding this insufficient to evidence a unitary business, the Court quoted the following with approval from Keesling and Warren, *The Unitary Concept and The Allocation of Income*, 12 Hastings L.J. 42, 52 (1960):

> Central accounting, for instance, may result in some savings, but in most instances the amount is trifling in comparison to the income of the various series of business activities for which the accounting is performed. Alone con-

> sidered, it is too weak a connecting link to bind into one business what should be separate businesses.

F.W. Woolworth Co. v. Taxation and Revenue Department, 73 L. Ed. 2d at 831, n. 22. The Appellant's Montana operations are separate and distinct from its out-of-state operations. The administrative services provided by the corporation's home office to the Montana ranch operations are too weak a connecting link to evidence a unitary business.

3. *Transfer of Funds.*

In *Woolworth*, the New Mexico Supreme Court, in finding a unitary business, relied upon the fact that the parent had commingled its dividend income from its foreign subsidiaries with its general funds and used them for general operating purposes. In response, this Court held that such an analysis "subverts the unitary business limitation". *F.W. Woolworth Co. v. Taxation and Revenue Department*, 73 L. Ed. 2d at 827, n. 11. Expanding on this point, this Court in *Container* stated that the exchange of value necessary to relate out-of-state and in-state enterprises was not met by the "mere flow of funds arising out of a passive investment or a distinct business operation". *Container Corporation v. Franchise Tax Board*, 51 U.S.L.W. at 4989. Here, the flow of funds between the corporation and the Montana operations clearly arose from an operation distinct in every significant business sense from the Appellant's paper box activities.

As noted in *Container*, the fund transfers between the corporation and the Montana operations served only an investment function. The transfers to the Montana operations helped maintain an investmet which otherwise would have had to borrow from outside sources. Transfers to the home office involved funds not currently required by the Montana operations. These transfers served no

operational function of the paper box divisions and are not sufficient to constitute a unitary business. *Container Corporation v. Franchise Tax Board*, 51 U.S.L.W. at 4993, n. 19.

The factors relied upon by the Appellee to justify its position herein are not sufficient, given the recent decisions of this Court, to justify application of the unitary business principle to the Appellant's business operations. Similarly, the facts involved here, which demonstrate that the Appellant's Montana operations are distinct business enterprises, reveal that the decision of the Montana Supreme Court falls outside the "realm of permissible judgment." *Norton Company v. Department of Revenue*, 340 U.S. 534, 538 (1951). As such, that judgment is not entitled to deference from this Court. The evidence in this case clearly indicates that Montana seeks to extend the scope of the unitary business principle.

By distinguishing on purely factual grounds the decisions of this Court in *ASARCO* and *Woolworth*, the Montana Supreme Court has failed to apply the correct legal standards to the facts of this case. The particular facts of this case indicate that, in permitting application of the unitary business principle to the Taxpayer, the Montana Supreme Court has erred and its judgment falls well outside the realm of permissible judgment.

The Montana operations are connected to the Appellant's other operations with the most minimal of links, all of which arise from unity of ownership. The centrality of common ownership to the position of the Appellee is shown by the decision, following remand, of the Montana Supreme Court. In attempting to distinguish *ASARCO* and *Woolworth*, the Montana court noted that those two cases involved foreign investments in the form of subsidiaries which had separate directors, officers and staff.

Here, the Montana court noted the ranch divisions were not subsidiaries but active operations of the Appellant which operated under the auspices of its board and officers. These "distinctions" mark no real difference between *ASARCO*, *Woolworth* and this case. In addition to elevating form over substance, such distinctions would subvert the constitutional limitations of the unitary business principle.

This case presents the Court with the opportunity to delimit the applicability of the unitary business principle, to give definition to the concept of discrete business enterprises, and to state that the elements relied on here are not sufficient to constitute a unitary business. Finally, this case allows this Court to address an element relied upon by the Montana court to justify its decision. The Montana court noted the treatment of Appellant's Montana operations in the income tax returns it filed in other states in which it operates. In those states the Appellant filed its tax returns under the unitary apportionment formula, which included the operations of the ranch divisions. The Montana court thought this an admission that the ranches were part of a unitary business. However, as this Court has stated, the constitutionality of a state tax should not depend on the vagaries of another state's tax policy. *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. at 444, *Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. at 228-229. The issue here is the constitutional scope of the taxing authority of the State of Montana. The actions of other states in applying the unitary business principle or of the Appellant in filing in other states cannot confer constitutional propriety upon the position of the Appellee in this case.

Here the Montana operations do not form a part of a functionally integrated enterprise and are, in fact, discrete

business enterprises having no functional connection with the out-of-state operations of the Appellant. In such circumstances, the unitary business principle cannot be applied, and the income from the Appellant's out-of-state operations cannot be apportioned to Montana without violation of the Due Process Clause of the Fourteenth Amendment. The construction of Montana's statute by its Supreme Court and its application to the Taxpayer present a clear violation of the Due Process Clause and present this Court with an important opportunity to define the limits of the unitary business principle.

B. *Constitutionality of State taxation of a corporation's net income, derived from operations both within and outside the taxing State, where the corporation's operations within the taxing State had no net income, and the net income apportioned to the taxing State is 19% to 30% of the total net income of the corporation.*

This Court has required a rational relationship between income attributed to a state by use of an apportionment formula and the intrastate values of the enterprises. *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. at 436-37; *Moorman Manufacturing Company v. Bair*, 437 U.S. 267, 272-73 (1978). Here, the application of the three-factor formula to the operations of the Appellant, both within and outside the state of Montana, has allocated to Montana income which is "out of all appropriate proportion to the business transacted by Appellant in Montana". *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931). The formula employed by the Appellee has led to a "grossly distorted result." *Norfolk and Western Railroad Company v. Missouri State Tax Commission*, 390 U.S. 317, 326 (1968).

In the years in question, the expenses and deductions of the ranch divisions exceeded gross income and there was

no net income attributable to those divisions. During that same time, the sales of the ranch divisions constituted between 1% and 7% of the corporation's total sales, while the payroll of the ranch divisions was between 3.2% and 15.5% of the total payroll of the corporation. In each of these years, the Appellant paid a minimum corporate license tax of $50.

The formula applied by the Appellee in re-assessing the tax years in question apportioned between 19% and 30% of the total net income of the corporation to Montana. This formula converted net losses sustained by the ranch divisions into substantial amounts of net income and increased the tax due from the Appellant by between 521 and 896 times.

The Due Process Clause requires that the factors used in an apportionment formula "must actually reflect a reasonable sense of how income is generated". *Container Corporation v. Franchise Tax Board*, 51 U.S.L.W. at 4990. Here, the percentage of allocation used by the Appellee far exceeded the percentage that Montana sales bore to the corporation's total sales. The functional value of the Montana operations, in terms of producing income taxable under the corporation license tax, can only result from sales made by the Montana operations. In each of the years involved, the gross sales of the Montana operations ranged between 1.1% and 7.3% of the total sales of the corporation. However, the total amount of net income allocated to Montana ranged between 19% and 30% of the corporation's total net income.

In the face of such figures there can be no doubt that no rational relationship exists between the income attributed to the state and the intrastate values of the enterprise. These figures also reveal that the methodology employed by the Appellee increases taxable income attributable to

Montana and the tax to be paid by the Appellant in percentages which far exceed the percentage increases which led this Court to strike down state taxes in *Hans Rees' Sons* and in *Norfolk and Western*.

In Hans Rees' Sons, this Court struck down, as arbitrary and unreasonable, a North Carolina tax which apportioned 80% of the Appellant's income to North Carolina despite the fact that the evidence tended to show that between 17% and 21% of the Appellant's income had its source in that state. Such an allocation bore no reasonable relationship or appropriate proportion to the business transacted by the Appellant in the taxing state.

This Court in *Norfolk and Western* found that Missouri exceeded its constitutional authority when its mileage formula resulted in the allocation of 8.28% of the railroad's total rolling stock to Missouri when an actual count showed that rolling stock usually employed in the state comprised approximately 2.71% of the total fleet.

The disproportionate nature of the allocation made by the State of Montana is far greater than those presented in *Hans Rees' Sons* and *Norfolk and Western*. There is no rational relationship between the income attributed to Montana and the intrastate value of the Montana activities. The Montana Supreme Court in its initial decision based its finding of a rational relationship upon its earlier finding that the Appellant's Montana operations were part of a unitary business.

> The "rational relationship" requirement is met in this case also. Ward was operated as a unitary business and as discussed earlier its operation in Montana was both dependent upon and contributory to its operation outside the state. Therefore, the portion of Ward's total income attributed to Montana under Montana's three-factor apportionment formula is rationally related to the intrastate value of the corporation.

App. A, p. 19.

The reasoning of the Montana Supreme Court, if left intact, virtually eliminates the requirement of a "rational relationship". Once the business is found to be unitary, any portion of the net income attributed to the taxing state is rationally related to the intrastate values. This circuitous reasoning subverts the due process limitations upon the unitary business principle and brings to mind Justice Holmes' warning in *Fargo v. Hart*, 193 U.S. 490, 499-500 (1904):

> It is obvious, however, that this notion of organic unity may be made a means of unlawfully taxing the privilege, or property outside the state, under the name of enhanced value or goodwill, if it is not closely confined to its true meaning.

Thus, this case presents this Court with an opportunity to confine the unitary business principle to its true meaning and to give further definition to the requirement of a rational relationship between income attributed by use of the formula and the intrastate values of the enterprise.

While states cannot be held, by the use of their apportionment formulas, to obtain exact measures of intrastate values, when the taxpayer evidences that the formula yields "a grossly distorted result in its particular case, the State is obliged to counter that evidence or to make accommodations necessary to assure that its taxing power is confined to its constitutional limits." *Norfolk and Western Railroad Company v. Missouri State Tax Commission*, 390 U.S. at 329. As such, this case presents a substantial federal question which requires plenary consideration by this Court for its resolution.

CONCLUSION

Appellant respectfully submits that the questions presented involve substantial federal issues and warrant plenary consideration by this Court following the submission of briefs and oral argument. Accordingly, probable jurisdiction should be noted.

Respectfully submitted,

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